J.C. Penney Company, Inc.
1988 Annual Report

Chairman of the board of directors and chief executive officer William R. Howell and Gale Duff-Bloom, vice president and director of investor relations, meet to discuss the Company's appearance before the Merchandising Analysts Group in New York City on April 19, 1989. Mrs. Duff-Bloom confers frequently with Mr. Howell and other members of senior management in the course of preparing communications for the financial community.

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The 1988 Annual Report

As is indicated by the cover of this Report and the 12-page supplement that accompanies it, JCPenney is continually sharpening its focus on women shoppers. It is they who make our business tick, who account for some 80 per cent of all merchandise purchased in regional shopping centers, and for whom we are striving to make our stores exciting places to shop for the kinds of apparel and accessories that will see them through their 'round-the-clock activities appropriately and in style.

Keeping present customers and wooing new ones is no easy task in the competitive world of retailing. We have found, though, in our 86 years of serving American consumers, that it helps to keep up with the times. In other words, being willing to change and to innovate, which you'll read more about in the pages that follow.

On the Cover

The bold black and white shopping bags carried by the lovely shopper on our cover are representative of the dramatic graphic materials and in-store presentation that will set the stage for our "Spirit of the American Woman" event in October 1989. Typical of the type of merchandise that will be featured in this promotion, which will be held in all JCPenney stores, is the model's three piece coordinated ensemble of oversize jacket with polka dot shell and matching pleated skirt.

This is JCPenney

JCPenney is a major retailer, with stores in all 50 states and Puerto Rico. The dominant portion of the Company's business consists of providing merchandise and services to consumers through stores, including catalog operations. The Company markets predominantly family apparel, shoes, and furnishings and accessories for the home.

Annual Meeting

Our Annual Meeting of Stockholders will be held at 10 A.M., Friday, May 19, 1989, at the Four Seasons Olympic Hotel, 411 University Street, Seattle, Washington. You are cordially invited to attend. A proxy statement, including a request for proxies, will be mailed to stockholders on or about April 13, 1989.

To Our Stockholders:

The Company's net income in 1988 totaled $807 million, or $6.02 per share. This compared with $608 million, or $4.11 per share, in 1987.

The almost $200 million increase in net income in 1988 reflected primarily an after tax gain of $139 million on the sale of our former headquarters building in New York City. In contrast, two nonrecurring items in the prior year, a provision for the Company's central office relocation to the Dallas, Texas, area and the loss on the sale of the Belgian operation, resulted in an after tax charge of $98 million. An additional supporting factor in 1988 was the decline in our effective income tax rate to 32.3 per cent from 37.9 per cent in 1987.

Net income before the nonrecurring items was $668 million in 1988, about 5 per cent lower than the preceding year's $706 million, with the LIFO impact a significant factor in the decline. Primary earnings per share amounted to $4.96 in 1988, up from $4.77 in 1987. This gain relates to the lesser number of shares outstanding— an average of 17 million fewer— in 1988.

Retail Sales Performance

Retail sales overall, at $14.8 billion, rose 0.4 per cent after excluding sales of the Belgian operation, which was sold in 1987. JCPenney stores' performance lagged, but this was offset by substantial gains by catalog and drug stores.

The decrease in JCPenney stores' sales was accounted for principally by the phaseout during the year of such high volume lines as home electronics, hard sporting goods, and photographic equipment. As we previously reported to you, the elimination of this merchandise, which we continue to offer through catalog, has enabled our stores to devote the much needed space to our major areas of concentration—apparel and soft home furnishings.

Other measurements of store performance are to be commended—in particular the decline in markdowns and the improvement in gross margin in face of steady increases in the costs of goods we purchased. Price inflation, which was greatest in the second half, resulted in a LIFO charge in 1988 of $125 million, as compared with $45 million in 1987.

We made substantial physical adjustments last year to 400 of our largest stores to accommodate broader soft line merchandise assortments. We also continued to open new stores and to close unproductive units. In metropolitan markets, we opened 20 stores, of which the majority were relocations of existing units, and we closed 21. As for geographic stores, 23 were opened and 45 closed.

Record Year for Catalog

Catalog had its third straight record year, with operating profits in excess of the previous year's total despite substantial increases in paper, ink, and postage costs. The success of our catalog in recent years says to us that we know our customers and that they like our merchandise, our quality, our prices, and our service.

Financial Highlights (In millions except per share data)

For the Year	1988	1987	1986
Retail sales	**$14,833**	$15,332	$14,740
Net income	**$ 807**	$ 608	$ 478
Net income per common share			
Primary	**$ 6.02**	$ 4.11	$ 3.19
Fully diluted	**$ 5.92**	$ 4.11	$ 3.17
Dividends per common share	**$ 2.00**	$ 1.48	$ 1.24

Our catalog associates are now doubling their efforts to provide better than expected quality without raising prices. A unique service feature is also on their agenda. Beginning this Summer, consumers throughout the United States will be able to call just one 800 number and whether they're ordering merchandise, checking on its delivery, or questioning an invoice, the person at the other end of the line will have access to their complete file and be able to respond immediately.

Catalog's ties to the JCPenney store remain as strong as ever. A very large part of catalog's business depends on store referrals, and the majority of catalog orders are picked up at stores. A substantial increase in catalog's sales of home electronics last year can be traced to the discontinuance of this line of merchandise in JCPenney stores.

This Spring, we plan to offer a selection of catalog merchandise via JCPenney Television Shopping Channel, utilizing Shop Television Network, Inc. as its exclusive production company for a 24-hour-a-day home shopping network currently available to some 5 million cable subscribers. Merchandise ordered in this way can be picked up at more than 1,400 JCPenney locations and the Penney credit card can be used for purchases.

Thrift Drug's Sales and Profits Up

Strong prescription sales in stores and the mail order operation were major contributors to a successful year for our Thrift Drug operation. Both sales and profits reached record levels. Thirty-four stores were opened in 1988 and at year end, access to our mail order pharmacy was available to some 3.1 million people through some 500 group accounts in all 50 states. Point-of-sale equipment, currently in 140 drug stores, will be installed in an additional 160 units in 1989. The remaining 100 plus stores will be so equipped in 1990. Enhanced efficiency and effectiveness in serving customers' needs are the goals.

Among our specialty retailing businesses, our Units women's specialty stores, which offer poly-cotton free size separates, recorded excellent progress both in terms of sales and profitability in 1988. We were also encouraged by the results turned in by our three Portfolio freestanding furniture stores and plan to open an additional eight units in 1989.

The Company's revenues from other than retail operations totaled $463 million, as compared with $415 million in 1987. The major source of these funds was premiums earned by our insurance operations. Other contributors were the JCPenney National Bank and JCP Realty, Inc. More about these activities can be found in our Financial Review.

The poor results of our casualty insurance activity, coupled with a lack of synergism with JCPenney stores in which it was offered, prompted our decision late last year to exit this business. On February 1, 1989, we disclosed that we were discussing the sale of the field claims, field sales, and home office operations in Westerville, Ohio, with several interested parties. At the time of this writing, we are encouraged by the progress of these talks. We will, of course, continue to operate the JCPenney Life Insurance Company, which offers life, health, and credit insurance through direct response.

Headquarters Plans

As was indicated earlier, we have concluded the sale of our former headquarters building in New York City. The selling price was approximately $350 million. We are now in the early stages of preparing for our eventual central office site in Plano, Texas, just a few miles north of our temporary quarters in the Dallas area. Harwood K. Smith & Partners (HKS) has been selected to design the new offices and prepare a master plan for the 429-acre site. The planning process is expected to take two years, with another two years for actual construction.

Dividend Action

In another development of particular significance to stockholders last year, the Company's Board of Directors increased the regular quarterly dividend by 35 per cent to 50 cents a share. This followed a two-for-one stock split and a 19 per cent dividend increase in 1987. The dividend actions are indicative of the Company's increasingly strong financial condition.

We are, in addition, sufficiently confident of our prospects for profitable future growth that we have continued to buy back our stock. Approximately 28 million shares have been repurchased since Fall 1987 of a total of 35 million authorized by the Board of Directors. Recent purchases have been made in conjunction with the creation of a leveraged employee stock ownership plan (LESOP). The LESOP, which is described in detail in the Financial Review, is intended to enhance cash flow, earnings per share, and return on equity while providing our Penney associates with a more attractive benefit plan.

Personnel Changes

Personnel changes of particular interest in the past year included the retirements of executive vice presidents A. Scott Frahlich and Thomas J. Lyons. Their successors, respectively, are James E. Oesterreicher, who moved from President of the Western Region to Director of JCPenney Stores, and Terry S. Prindiville, who became responsible for real estate and construction services, systems and data processing, company communications, planning and research, and drug stores. Coincident with Mr. Prindiville's appointment, the Southwestern Region that he had headed was consolidated with the southern portion of the Western Region under William J. Ferguson. The northern part of the Western Region became allied with the Central Region, with the ultimate aim of this restructuring a more efficient system for distributing weather-related merchandise to stores. Cost savings will also be realized.

In January 1989, we were saddened by the death of our friend and fellow member of the Board of Directors David B. Meeker. Mr. Meeker had a long career with Hobart Corporation and was that company's president and chief executive officer from 1970 to 1981. He joined our Board in 1983 and in the intervening years served with distinction. We will miss him.

Summing up the year just past, I cannot help but reflect on the changes and the challenges we encountered. Our relocation to the Dallas area; the parting of some long time loyal associates for whom the move was impossible for family or other reasons; the screening and hiring of replacements both from within and outside our own ranks; decisions about homes and schools: all of these situations colored our year both as individuals and as a Company. We have emerged, I believe, reinvigorated; confident of the correctness of our decision to relocate; sure of the soundness of our direction; and eager to continue to expand our businesses step by step and brick by brick.

Warmest regards,

W R Howell

William R. Howell
Chairman of the Board

March 24, 1989

Consolidated Statement of Income (In millions except per share data)

J.C. Penney Company, Inc. and Subsidiaries

For the Year	1988	1987	1986
Revenue			
Retail sales	**$14,833**	$15,332	$14,740
Other revenue	**463**	415	411
Total revenue	**15,296**	15,747	15,151
Costs and expenses			
Cost of goods sold, occupancy, buying, and warehousing costs	**9,717**	10,152	9,786
Selling, general, and administrative expenses	**3,815**	3,743	3,668
Costs and expenses of other businesses	**487**	401	383
Interest expense, net	**307**	300	350
Nonrecurring items	**(222)**	172	—
Total costs and expenses	**14,104**	14,768	14,187
Income before income taxes	**1,192**	979	964
Income taxes	**385**	371	434
Income before extraordinary charge	**807**	608	530
Extraordinary charge on debt restructure, net of income taxes of $49	**—**	—	52
Net income	**$ 807**	$ 608	$ 478
Earnings per common share			
Primary			
Income before extraordinary charge	**$ 6.02**	$ 4.11	$ 3.53
Extraordinary charge, net of income taxes	**—**	—	.34
Net income	**$ 6.02**	$ 4.11	$ 3.19
Fully diluted			
Income before extraordinary charge	**$ 5.92**	$ 4.11	$ 3.51
Extraordinary charge, net of income taxes	**—**	—	.34
Net income	**$ 5.92**	$ 4.11	$ 3.17

Consolidated Statement of Reinvested Earnings (In millions)

	1988	1987	1986
Reinvested earnings at beginning of year	**$3,213**	$3,379	$3,122
Net income	**807**	608	478
Unrealized change in equity securities and translation adjustment	**2**	(4)	7
Retirement of common stock	**(688)**	(514)	(42)
Two-for-one stock split	**—**	(38)	—
Common stock dividends declared	**(260)**	(218)	(186)
Preferred stock dividends declared, net	**(17)**	—	—
Reinvested earnings at end of year	**$3,057**	$3,213	$3,379

See Summary of Accounting Policies on pages 8 and 9 and 1988 Financial Review on pages 9 through 21.

Consolidated Balance Sheet (In millions)

J.C. Penney Company, Inc. and Subsidiaries

Assets	1988	1987	1986
Current assets			
Cash and short term investments of $653, $84, and $534	**$ 670**	$ 112	$ 639
Receivables, net	**4,233**	4,536	4,614
Merchandise inventories	**2,201**	2,350	2,168
Prepaid expenses	**142**	132	111
Total current assets	**7,246**	7,130	7,532
Properties, net of accumulated depreciation and amortization of $1,429, $1,346, and $1,275	**3,034**	2,910	2,919
Other assets	**1,974**	1,694	1,395
	$12,254	$11,734	$11,846

Liabilities and Stockholders' Equity	1988	1987	1986
Current liabilities			
Accounts payable and accrued expenses	**$ 1,666**	$ 1,595	$ 1,489
Short term debt	**756**	955	597
Current maturities of long term debt	**244**	—	484
Deferred taxes, principally installment sales	**119**	136	142
Total current liabilities	**2,785**	2,686	2,712
Long term debt	**3,064**	2,608	2,655
Deferred taxes	**1,346**	1,375	1,481
Other liabilities	**1,102**	892	658
Stockholders' equity			
Preferred stock, without par value: Authorized, 25 million shares— issued, 1 million shares of Series B LESOP convertible preferred	**706**	—	—
Guaranteed LESOP obligation	**(668)**	—	—
Common stock, par value 50¢: Authorized, 500 million shares— issued, 123, 138, and 150 million shares	**862**	960	961
Reinvested earnings	**3,057**	3,213	3,379
Total stockholders' equity	**3,957**	4,173	4,340
	$12,254	$11,734	$11,846

See Summary of Accounting Policies on pages 8 and 9 and 1988 Financial Review on pages 9 through 21.

Company Statement on Financial Information

The Company is responsible for the information presented in this Annual Report. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and are considered to present fairly in all material respects the Company's results of operations, financial position, and cash flows. Certain amounts included in the consolidated financial statements are estimated based on currently available information and judgment of the outcome of future conditions and circumstances. Financial information elsewhere in this Annual Report is consistent with that in the consolidated financial statements.

The Company's system of internal accounting controls is supported by written policies and procedures and supplemented by a staff of internal auditors. This system is designed to provide reasonable assurance, at suitable costs, that assets are safeguarded and that transactions are executed in accordance with appropriate authorization and are recorded and reported properly. The system is continually reviewed, evaluated, and, where appropriate, modified to accommodate current conditions. Emphasis is placed on the careful selection, training, and development of professional managers.

An organizational alignment that is premised upon appropriate delegation of authority and division of responsibility is fundamental to this system. Communication programs are aimed at assuring that established policies and procedures are disseminated and understood throughout the Company.

The consolidated financial statements have been audited by independent auditors whose report appears on page 6.

The Audit Committee of the Board of Directors is composed solely of directors who are not officers or employees of the Company. The Audit Committee is responsible for recommending to the Board the engagement of the independent auditors for the purpose of conducting the annual audit of the Company's consolidated financial statements. Company personnel, including internal auditors, and the independent auditors meet periodically with the Audit Committee to review financial statements and discuss auditing and financial reporting matters.

Consolidated Statement of Cash Flows (In millions)

J.C. Penney Company, Inc. and Subsidiaries

For the Year	1988	1987	1986
Operating activities			
Income before extraordinary charge	**$ 807**	$ 608	$ 530
Gain on sale of headquarters building	**(222)**	—	—
Deferred taxes	**(46)**	(112)	273
Depreciation and amortization	**258**	241	229
Amortization of original issue discount	**60**	52	46
Nonrecurring items	**—**	172	—
Change in cash from:			
Customer receivables	**337**	70	(51)
Inventories, net of trade payables	**273**	(170)	261
Other assets and liabilities, net	**(169)**	(56)	(51)
	1,298	805	1,237
Investing activities			
Capital expenditures	**(481)**	(376)	(348)
Proceeds from sale of headquarters building	**302**	—	—
Other investments	**(7)**	(55)	(11)
	(186)	(431)	(359)
Financing activities			
Increase (decrease) in short term debt	**(199)**	427	(143)
Issuance of long term debt	**200**	202	597
Payments of long term debt	**(214)**	(728)	(618)
Extraordinary charge on retirement of debt	**—**	—	(39)
Common stock retired, net	**(781)**	(589)	(11)
Preferred stock issued	**706**	—	—
Dividends paid	**(266)**	(213)	(183)
	(554)	(901)	(397)
Increase (decrease) in cash and short term investments	**$ 558**	$ (527)	$ 481
Supplemental cash flow information			
Interest paid	**$ 278**	$ 281	$ 325
Interest received	**$ 29**	$ 24	$ 27
Income taxes paid	**$ 350**	$ 407	$ 95

See Summary of Accounting Policies on pages 8 and 9 and 1988 Financial Review on pages 9 through 21.

Independent Auditors' Report

To the Stockholders and Board of Directors of J.C. Penney Company, Inc.:

We have audited the accompanying consolidated balance sheets of J.C. Penney Company, Inc. and Subsidiaries as of January 28, 1989, January 30, 1988, and January 31, 1987, and the related consolidated statements of income, reinvested earnings, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of J.C. Penney Company, Inc. and Subsidiaries at January 28, 1989, January 30, 1988, and January 31, 1987, and the results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

1601 Elm, Dallas, Texas 75201
February 16, 1989

Peat Marwick Main & Co.

Management's Discussion and Analysis of Results of Operations and Financial Position

Results of operations	1988	1987	1986
Domestic retail sales, per cent increase	**0.4**	4.6	6.3
Gross margin, per cent of retail sales	**34.5**	33.8	33.6
Selling, general, and administrative expenses, per cent of retail sales	**25.7**	24.4	24.9
Interest expense, net, per cent of retail sales	**2.1**	2.0	2.3
Income before income taxes and nonrecurring and extraordinary items, per cent of total revenue	**6.3**	7.3	6.4
Income before nonrecurring and extraordinary items, per cent of total revenue	**4.4**	4.5	3.5

Income before nonrecurring and extraordinary items decreased 5.4 per cent to $668 million from $706 million in 1987 and compares with $530 million in 1986. The decline in 1988 is primarily attributable to a significant increase in the LIFO reserve and the costs of discontinuing home electronics, hard sporting goods, and photographic equipment. The increase in income in 1987 was attributable to higher sales coupled with slightly higher gross margin and tight expense control. In 1986, income increased due to higher sales and improved gross margin.

Income per share on a primary basis, before nonrecurring and extraordinary items, was $4.96, up from $4.77 in 1987, and $3.53 in 1986. Income per share in 1988 benefited from fewer shares of common stock outstanding, due to the stock buy back programs of 1987 and 1988.

Nonrecurring items in 1988, on a pre-tax basis, included the $222 million gain on the sale of the Company's former corporate headquarters building. On an after-tax basis, this gain increased the Company's earnings by $139 million, or $1.06 per share on a primary basis. In 1987, nonrecurring items included the provision for relocation and the loss on the sale of the Belgian operation, which together reduced net income $98 million, or 66 cents per share.

Net income in 1988 was $807 million, up 32.7 per cent from last year's $608 million. Net income was $478 million in 1986.

Retail sales for 1988 declined 3.3 per cent to $14,833 million from $15,332 million in 1987 due to the sale of the Belgian operation in late 1987. In 1988, the Company continued to sharpen its focus on the lines of merchandise which offer superior profit opportunities: women's, men's, and children's apparel and soft home furnishings. During the year, the Company completed the phase out of home electronics, photography, and hard sporting goods merchandise from retail stores, announced in 1987. If the sales of these discontinued lines and the sales of the Belgian operation were excluded, retail sales increased 3.5 per cent.

Gross margin, as a per cent of retail sales, improved in 1988 due to the greater emphasis on family apparel and the sale of the low margin Belgian operation in 1987. For the year, gross margin exceeded the previous year's by 70 basis points despite the impact of the LIFO method of inventory valuation. As a result of a higher level of inflation in apparel merchandise in 1988 than in the previous two years, the LIFO charge amounted to $125 million, as compared with $45 million in 1987 and $10 million in 1986. Gross margin improved slightly in 1987. Gross margin improved in 1986 primarily as a result of lower markdowns.

Selling, general, and administrative expenses continued to be well controlled in 1988. SG&A expenses increased a modest 1.9 per cent in 1988, 2.0 per cent in 1987, and 6.2 per cent in 1986. As a per cent of retail sales, SG&A expenses increased in 1988 to 25.7 per cent from 24.4 per cent in 1987 as a result of the lower sales volume. In 1987 and 1986, this expense ratio declined slightly. Finance charge revenue, which reduces these expenses, declined in 1988 partially due to the sale of a portion of the Company's credit card receivables.

Costs and expenses of other businesses at $487 million, was $86 million over last year. The increase was attributable to costs associated with the expansion of the banking operation and developmental costs associated with the Company's interactive television program, Telaction, and its video home shopping venture, Shop Television Network (STN). Costs and expenses of other businesses were $383 million in 1986.

Interest expense in 1988 increased slightly because of higher borrowing levels. Interest was favorably affected by the temporary investment of the proceeds from the sale of convertible preferred stock to the leveraged employee stock ownership plan (LESOP) and by reduced borrowings resulting from the sale of a portion of the credit card receivables and the sale of the former headquarters building in New York City. In 1987, interest expense declined as a result of benefits realized from the debt restructure program, lower average borrowing levels, and lower interest rates. Interest expense decreased in 1986 due to lower interest rates and benefits realized from the debt restructure program.

The effective income tax rate for 1988 was 32.3 per cent, as compared with 37.9 and 45.0 per cent for 1987 and 1986, respectively. The reduction was principally due to the change in the statutory rate to 34 per cent in 1988 from 39 per cent in 1987 and 46 per cent in 1986. Additionally, as a result of the Tax Reform Act of 1986, income taxes were reduced $42 million and $17 million in 1988 and 1987 due to the payment of a portion of the taxes on installment sales previously deferred at higher tax rates.

Financial Position. The Company generated sufficient cash in 1988 to meet its operating requirements, capital expenditures, dividend payments, and to support its stock buy back program. Cash generated through operating activities increased $493 million during the year as a result of a lower investment in merchandise inventory and the sale of $250 million of customer receivables. Cash was also generated from the sale of the Company's former headquarters building.

Merchandise inventories decreased to $2.2 billion in 1988, down 6 per cent from 1987. Inventories increased 8 per cent in 1987 and decreased 6 per cent in 1986. In 1988, the Company continued to concentrate its merchandise mix on women's, men's, and children's apparel and soft home furnishings.

Customer accounts receivable were $3.9 billion at the end of 1988, or 8 per cent below the level at the end of 1987. The decline in the 1988 receivables level is principally due to the sale of $250 million of receivables. These receivables were sold through a trust which issued $250 million of asset-backed certificates with an expected maturity of three years. The primary objective of this transaction was to increase the financial flexibility of the Company's capital structure by providing a readily available access to a significant source of funds. Customer accounts receivable were $4.2 billion at the end of 1987, or about 2 per cent below the level at the end of 1986.

Property, plant, and equipment, at $3.0 billion, was $124 million over last year. Capital expenditures in 1988 were $487 million, $111 million above the level of 1987. The increase in capital expenditures was principally related to the cost of converting the space in JCPenney stores from the discontinued home electronics, photography, and hard sporting goods lines to women's apparel. Capital expenditures were $350 million in 1986.

During 1988, the Company continued its debt restructure program by calling a total of $152 million for two issues of high coupon long term debt and by issuing $200 million of 9.45 per cent Notes due 1998. Total debt at year end includes $668 million of borrowings by the LESOP, which is guaranteed by the Company. The source of funds to repay the LESOP debt will be dividends from the Series B preferred stock and cash contributions by the Company, totaling approximately $100 million in each of the next ten years.

Stockholders' equity was $4.0 billion at the end of 1988, a decline of $216 million from last year. Stockholders' equity was reduced in 1988 by $769 million from purchases in the open market of its common stock. In 1988, the Company completed the stock buy back program announced in 1987, totaling 20 million shares, at a total cost of $932 million. The Company is using the proceeds from the issuance of preferred stock to the LESOP to purchase up to an additional 15 million common shares in the open market. By the end of 1988, the Company had purchased 8 million shares of its common stock from this stock buy back program at a cost of $418 million.

The Company anticipates that the major portion of its cash requirements during the next few years to finance its operations and expansion and to repay amounts borrowed will continue to be generated internally from operations. The Company will continue to review all expenditures to maximize financial returns and maintain financial flexibility.

Additional Information. For additional discussion and analysis of 1988, see the 1988 Financial Review on pages 9 through 21.

Summary of Accounting Policies

The dominant portion of JCPenney's business consists of selling merchandise and services to consumers through stores, including catalog operations.

Basis of Consolidation. The consolidated financial statements present the results of J.C. Penney Company, Inc. and its subsidiaries. The accounts of JCPenney Life Insurance Company, JCPenney Casualty Insurance Company, JCPenney National Bank, and JCP Realty, Inc. are, for the first time, included in the Company's consolidated financial statements to reflect the adoption of Financial Accounting Standards Board Statement No. 94, "Consolidation of All Majority-Owned Subsidiaries." This change had no effect on net income; however, the financial statements have been restated to reflect the consolidation of these operations. Prior to 1988, these operations were presented as unconsolidated subsidiaries accounted for under the equity method.

Discussions are under way with several major insurance companies for the sale of the personal lines operations of JCPenney Casualty Insurance Company.

Definition of Fiscal Year. JCPenney's fiscal year ends on the last Saturday in January. Fiscal year 1988 ended January 28, 1989, 1987 ended January 30, 1988, and 1986 ended January 31, 1987. They comprised 52 weeks, 52 weeks, and 53 weeks, respectively. The accounts of JCPenney Life Insurance Company, JCPenney Casualty Insurance Company, and the JCPenney National Bank are on a calendar year basis.

Retail Sales. Retail sales include merchandise and services, net of returns, and exclude sales taxes.

Finance Charge Revenue. Finance charge revenue arising from the JCPenney credit card customer accounts receivable is treated as a reduction of selling, general, and administrative expenses in the consolidated statement of income.

Short Term Investments. Excess cash invested in instruments with maturities of three months or less from time of investment is reflected as short term investments.

Merchandise Inventories. Substantially all merchandise inventories are valued at the lower of cost (last-in, first-out) or market, determined by the retail method.

Depreciation. The cost of buildings and equipment is depreciated on a straight line basis over the estimated useful lives of the assets. The principal annual rates of depreciation are 2 per cent for buildings, 5 per cent for warehouse fixtures and equipment, and 10 per cent for selling fixtures and equipment. Improvements to leased premises are amortized on a straight line basis over the expected term of the lease or their estimated useful lives, whichever is shorter.

Deferred Charges. Expenses associated with the opening of new stores are written off in the year of store opening, except those of stores opened in January, which are written off in the following fiscal year. Catalog preparation and printing costs are written off over the estimated productive lives of the catalogs, not to exceed six months.

1988 Financial Review

Earnings per common share were calculated on the following basis:

Earnings per common share (In millions, except per share data)	**1988**	1987	1986
Primary			
Net income	**$ 807**	$ 608	$ 478
Dividend on preferred stock (after-tax)	**17**	—	—
Adjusted net income	**$ 790**	$ 608	$ 478
Weighted average number of shares	**131**	148	150
Net income per share	**$6.02**	$4.11	$3.19
Fully diluted			
Net income	**$ 807**	$ 608	$ 478
Weighted average number of shares (primary)	**131**	148	150
Convertible preferred stock and other	**5**	—	1
Weighted average number of shares	**136**	148	151
Net income per share	**$5.92**	$4.11	$3.17

Nonrecurring items included in the consolidated statement of income in 1988 reflect a pre-tax gain of $222 million on the sale of the Company's former headquarters building in New York City. In 1987, the Company recorded a pre-tax provision of $140 million for the aggregate cost of relocating the corporate headquarters to Dallas, Texas. The move was completed in 1988, and the provision was sufficient to cover all related costs. Also in 1987, the Company's Belgian operation was sold at a pre-tax loss of $32 million. The effect of nonrecurring items increased net income by $139 million, or $1.06 per share, in 1988 and reduced net income by $98 million, or 66 cents per share, in 1987.

Revenue

Retail sales in 1988 were $14,833 million, a decrease of 3.3 per cent from $15,332 million in 1987.

		Per cent increase (decrease) 1988 vs. 1987			Per cent increase 1987 vs. 1986		
Retail sales (In millions)	**1988**	All units	Comparative units	1987	All units	Comparative units	1986
JCPenney stores	**$13,364**	(0.5)	(2.2)	$13,428	4.2	3.9	$12,888
Catalog	**2,918**	12.9	13.6	2,585	10.9	11.0	2,332
Intracompany elimination	**(2,331)**	n/a	n/a	(2,033)	n/a	n/a	(1,830)
Total JCPenney stores and catalog	**13,951**	(0.2)	(1.9)	13,980	4.4	3.9	13,390
Drug stores	**882**	11.4	9.4	791	8.9	7.2	727
Domestic sales	**14,833**	0.4	(1.3)	14,771	4.6	4.1	14,117
Belgian operation*	**—**			561			623
Total	**$14,833**			$15,332			$14,740

The intracompany elimination represents the duplication of those catalog sales made through JCPenney stores and also included in Catalog. Comparative units are those in operation throughout both the current and prior year. For further analyses of retail sales, see the discussion below and the Five Year Operations Summary on page 23.

**Sold in 1987.*

Other revenue includes insurance premiums, income of JCPenney National Bank, and income from real estate development operations.

Other revenue (In millions)	**1988**	1987	1986
Casualty insurance premiums and investment income	**$184**	$195	$213
Life insurance premiums and investment income	**167**	156	150
Bankcard interest and fees	**90**	41	20
Real estate development operation	**22**	23	28
Total	**$463**	$415	$411

Retail Businesses

JCPenney stores' sales (In millions)	**1988**	Per cent increase (decrease) 1988 vs. 1987 — All units	Per cent increase (decrease) 1988 vs. 1987 — Comparative units	1987	Per cent increase 1987 vs. 1986 — All units	Per cent increase 1987 vs. 1986 — Comparative units	1986
Metropolitan markets	**$11,313**	(1.3)	(2.2)	$11,463	4.2	6.6	$11,001
Geographic markets	**2,051**	4.4	2.1	1,965	4.1	4.6	1,887
Total	**$13,364**	(0.5)	(2.2)	$13,428	4.2	3.9	$12,888

JCPenney stores are organized into two groups of stores, each representing separate and distinct markets.

Metropolitan market stores are located primarily in regional comparison shopping centers.

The Company had 698 stores in metropolitan markets at year end and an aggregate of 95 million gross square feet of space. Sales per square foot were approximately $118 for stores in operation throughout 1988. The Company continues to open new stores as opportunities arise and to close stores that do not meet performance objectives. During 1988, 20 metropolitan market stores were opened and 21 were closed.

Metropolitan market stores' profit was about the same as last year as slightly higher margins were offset by a decline in sales. Profit increased in 1987 and 1986 due to higher sales, improved gross margin, and expense controls.

Geographic market stores are in nonmetropolitan areas and in satellite towns within metropolitan areas.

At year end, the Company had 657 geographic market stores in operation and an aggregate of 19 million gross square feet of space. Sales per square foot were approximately $113 for stores in operation throughout 1988. During 1988, 23 geographic stores were opened and 45 were closed. The Company continues to expand into new markets and close unproductive stores.

Geographic market stores' profit increased slightly in 1988 due to improved gross margin. Profit increased in 1987 and 1986 due to higher gross margin and expense controls.

Discontinued lines. During 1988, the Company completed the phase out of home electronics, photography, and hard sporting goods merchandise, announced in 1987. These lines will continue to be offered through Catalog. Sales of JCPenney stores, excluding these lines, were as follows:

	1988	1987	1986
Total sales of JCPenney stores	**$13,364**	$13,428	$12,888
Discontinued lines	**131**	568	720
Sales of continuing lines	**$13,233**	$12,860	$12,168
Per cent increase	**2.9%**	5.7%	6.6%

The more than four million square feet of space made available by discontinued lines was reallocated primarily into the more profitable women's apparel lines. In addition, the concept of segmentation was implemented in the women's department whereby the department is presented in distinct categories that target five different consumer types. These five types are the traditional, updated, conservative, junior, and young junior woman. Each type targets a different lifestyle, a different fashion attitude, and different merchandise needs.

Eight separate departments in women's sportswear and three sub-departments in women's and petites focus on these five distinct consumer types. In effect, each department forms a separate "store" within the larger JCPenney store. This concept works for all JCPenney stores, regardless of size. While smaller stores may not have enough space to separate departments physically, they still organize merchandise by target consumers, using appropriate cues or signals.

As space has been reallocated, JCPenney store's merchandise mix as a per cent of merchandise sales continues to shift more toward women's and men's apparel. The present merchandise mix is approximately 42 per cent women's apparel, 27 per cent men's apparel, 13 per cent children's apparel, and 18 per cent home furnishings.

Several organizational changes occurred within JCPenney stores during the year. The Company's store organization was realigned from five geographical regions to four, and the merchandise and marketing departments were restructured. Both of these changes will enable JCPenney stores to better serve the needs of our targeted middle and middle/upper income families.

Catalog expands the Company's retailing capabilities by offering a wide range of merchandise to complement the stores' assortment. Two general catalogs are published, Fall & Winter and Spring & Summer, and each are circulated to more than 10 million customers. The general catalogs are supplemented by some 50 seasonal, promotional, and specialty catalogs. Merchandise offerings include family fashion and home furnishings, as well as automotive, sporting goods, home electronics, and other hardlines not carried in JCPenney stores.

Virtually all customer orders are called toll free to one of 15 telephone sales centers, where merchandise availability is confirmed or alternate selections offered. Most catalog orders are delivered to their destination within 48 hours from one of six catalog distribution centers. Orders are shipped to catalog departments in all JCPenney stores and selected Drug stores and to freestanding JCPenney catalog sales centers and independent catalog sales merchants. Home delivery orders are shipped directly to customers' homes or offices.

Catalog's profit increased in 1988 due to higher sales and tightly controlled operating expenses. Catalog profit increased dramatically in 1987 and 1986 due to increases in sales combined with improved gross margin and tight controls over advertising and operating expenses.

		Per cent increase 1988 vs. 1987			Per cent increase 1987 vs. 1986		
Catalog sales (In millions)	**1988**	All units	Comparative units	1987	All units	Comparative units	1986
JCPenney stores							
Metropolitan markets	**$1,558**	13.4	13.5	$1,374	10.7	11.9	$1,242
Geographic markets	**597**	12.7	14.5	530	8.4	11.5	490
Freestanding operations	**176**	36.6	12.8	129	31.1	13.2	98
Total	**2,331**	14.7	13.7	2,033	11.2	11.9	1,830
Drug stores	**94**	11.6	10.6	84	11.5	8.2	75
Sales merchants	**59**	33.5	n/a	44	70.7	n/a	26
Other, principally outlet stores	**434**	2.2	n/a	424	5.4	n/a	401
Total	**$2,918**	12.9	13.6	$2,585	10.9	11.0	$2,332

Number of catalog units	**1988**	1987	1986
JCPenney stores, metropolitan markets	**698**	699	707
JCPenney stores, geographic markets	**657**	679	696
Freestanding	**216**	172	144
Drug stores	**117**	120	118
Sales merchants	**176**	153	146
Other, principally outlet stores	**15**	14	14
Total	**1,879**	1,837	1,825

Drug stores, operating under the name Thrift Drug or The Treasury Drug Center, with an aggregate of 4.4 million square feet of gross selling space, offer typical drug store merchandise, including prescription drugs and health and beauty aid products. Thrift Drug's mail order pharmacy operation services the prescription needs of customers from major organizations by filling prescriptions through the mail. During 1988, 34 drug stores were opened and seven were closed. At year end, the Company operated 434 drug stores.

Drug stores' profits increased in 1988 as a result of higher sales, improved gross margin, and lower operating expenses. Profits declined in 1987 due to a slight decrease in gross margin and the influence of start-up costs associated with the opening of new stores. Profits increased in 1986 as a result of higher sales and improved gross margin.

Other Businesses

Costs and expenses of other businesses were as follows:

Costs and expenses of other businesses (In millions)	**1988**	1987	1986
Claims costs and expenses of casualty insurance operation	**$197**	$198	$241
Benefits, claims costs, and expenses of life insurance operation	**130**	120	110
Interest expense and bad debts of banking operation	**75**	38	16
Real estate development operation	**3**	3	2
Other, principally Telaction and Shop Television Network	**82**	42	14
Total	**$487**	$401	$383

JCPenney Life Insurance Company markets life, health, and credit insurance through direct response. JCPenney Life Insurance Company's 1988 net income increased from last year as a result of improved underwriting experience.

JCPenney Casualty Insurance Company recorded a net loss of $7 million in 1988 as a result of unfavorable underwriting experience.

Discussions are under way with several major insurance companies for the sale of the personal lines operation of JCPenney Casualty Insurance Company. The Company will not incur any significant gain or loss in exiting the casualty insurance business.

	Year ended December 31		
JCPenney Life Insurance Company (In millions)	**1988**	1987	1986
Premiums earned	**$133**	$121	$112
Investment income	**34**	35	38
Total revenues	**167**	156	150
Benefits, claims, and expenses	**130**	120	110
Income before income taxes	**37**	36	40
Income taxes	**12**	14	13
Net income*	**$ 25**	$ 22	$ 27

**Includes net realized investment gains of $1 million, $4 million, and $9 million in 1988, 1987, and 1986, respectively.*

	December 31		
JCPenney Life Insurance Company balance sheet (In millions)	**1988**	1987	1986
Assets			
Investments			
Fixed income, at amortized cost (market: $281, $304, and $248)	**$287**	$307	$239
Short term, at cost which equals market	**2**	14	22
Equity, at market (cost: $17, $18, and $25)	**15**	15	29
Other	**14**	13	12
Total investments	**318**	349	302
Deferred policy acquisition costs	**183**	170	158
Other assets	**50**	58	50
	$551	$577	$510
Liabilities and equity			
Policy and claims reserves	**$219**	$203	$175
Income taxes and other liabilities	**79**	96	81
Equity of JCPenney	**253**	278	254
	$551	$577	$510

	Year ended December 31		
JCPenney Casualty Insurance Company (In millions)	**1988**	1987	1986
Net income (loss)	**$ (7)**	$ 4	$ (13)

	December 31		
JCPenney Casualty Insurance Company (In millions)	**1988**	1987	1986
Net assets of JCPenney Casualty Insurance Company	**$107**	$111	$109

JCPenney National Bank offers Visa and MasterCard credit cards. At the end of the year, about 416 thousand credit cards were issued. Capital contributions and advances to the bank totaled $68 million in 1988, $10 million in 1987, and $28 million in 1986. The bank repaid a $63 million advance by the end of the Company's fiscal year 1988. The bank recorded net income of $5 million in 1988, as compared with breakeven results in 1987 and 1986.

JCPenney National Bank balance sheet (In millions)	December 31 1988	1987	1986
Assets			
Cash and short term investments	**$160**	$ 35	$ 15
Receivables, net of allowance for doubtful accounts of $17, $9, and $3	**384**	247	128
Other assets	**40**	31	22
	$584	$313	$165
Liabilities and equity			
Deposits	**$474**	$278	$ 85
Other liabilities	**14**	12	4
Due to JCPenney	**63**	—	64
Equity of JCPenney	**33**	23	12
	$584	$313	$165

JCP Realty, Inc. is engaged in the development and operation of real estate through participation in joint ventures.

At year end, JCP Realty had interests in more than 80 projects, primarily regional shopping centers. More than 60 of these were in operation, and the balance were in various stages of development.

JCP Realty recorded profits of $14 million, $13 million, and $18 million in each of the last three years. Included in 1988, 1987, and 1986 results were gains, net of taxes, of $15 million, $9 million, and $14 million, respectively, from sales of its interests in shopping center ventures. JCP Realty has advanced to JCPenney an amount in excess of its equity as follows:

Net investment in JCP Realty, Inc. (In millions)	1988	1987	1986
Amount advanced to JCPenney	**$(144)**	$(127)	$(114)
Equity of JCPenney	**110**	96	83
Net investment of JCPenney	**$ (34)**	$ (31)	$ (31)

Telaction and Shop Television Network. The Company has been involved in testing two television-distributed retail formats, Telaction and Shop Television Network (STN). Expenses, net of revenues, for these businesses were $68 million in 1988, $42 million in 1987, and $14 million in 1986.

Assets

Receivables (In millions)	1988	1987	1986
Customer receivables	**$3,876**	$4,213	$4,291
Less allowance for doubtful accounts	**71**	71	79
Customer receivables, net	**3,805**	4,142	4,212
Other receivables	**428**	394	402
Receivables, net	**$4,233**	$4,536	$4,614

In 1988, the Company transferred $346 million of its customer accounts receivable to a trust which in turn sold $250 million of certificates, representing undivided ownership interests in the trust, in a public offering. The certificates were sold to yield 9.13 per cent with an expected life of three years. As of January 28, 1989, the outstanding balances of the certificates and the receivables were $250 million and $401 million, respectively. The Company owns the remaining undivided interest in the trust not represented by the certificates and will continue to service all receivables for the trust.

Under the terms of the sale, a reserve fund available to the trust was established from the cash flows generated by the receivables to absorb defaulted accounts up to a certain limit. Additionally, the Company has made available to the trust an irrevocable letter of credit that may be drawn upon should the reserve fund be exhausted.

Merchandise inventories (In millions)	1988	1987	1986
Merchandise inventories, at lower of cost (FIFO) or market	**$2,599**	$2,623	$2,396
LIFO reserve	**(398)**	(273)	(228)
Merchandise inventories, at lower of cost (LIFO) or market	**$2,201**	$2,350	$2,168

Properties (In millions)	**1988**	1987	1986
Land	**$ 162**	$ 164	$ 140
Buildings			
Owned	**1,426**	1,430	1,458
Capital leases	**247**	247	247
Fixtures and equipment	**2,137**	1,983	1,904
Leasehold improvements	**491**	432	445
	4,463	4,256	4,194
Less accumulated depreciation and amortization	**1,429**	1,346	1,275
Properties, net	**$3,034**	$2,910	$2,919

Capital expenditures (In millions)	**1988**	1987	1986
Land	**$ 10**	$ 56	$ 2
Buildings	**81**	62	94
Fixtures and equipment	**319**	218	207
Leasehold improvements	**77**	40	47
Total capital expenditures	**$487**	$376	$350

Expenditures for existing stores, primarily modernizations, were $205 million in 1988, as compared with $160 million in 1987 and $172 million in 1986. The increase in capital expenditures for 1988 from 1987 principally represents the cost of converting space in JCPenney stores from the discontinued home electronics, photography, and hard sporting goods lines to primarily women's apparel. The increase in capital expenditures for 1987 from the prior year was related to the relocation of the corporate headquarters.

Other assets (In millions)	**1988**	1987	1986
Life insurance operation, principally investments	**$ 551**	$ 577	$ 510
Casualty insurance operation, principally investments	**308**	309	333
Bank operation, principally bankcard receivables	**584**	313	165
Investment in real estate joint ventures	**81**	74	58
Other	**450**	421	329
Total	**$1,974**	$1,694	$1,395

Liabilities and Stockholders' Equity

Accounts payable and accrued expenses (In millions)	**1988**	1987	1986
Trade payables	**$ 646**	$ 525	$ 555
Accrued salaries, vacations, profit-sharing, and bonuses	**348**	401	394
Taxes, including income taxes	**300**	244	216
Worker's compensation and public liability insurance	**95**	65	74
Dividend payable	**62**	51	46
Other	**215**	309*	204
Total	**$1,666**	$1,595	$1,489

**Includes provision for relocation of corporate headquarters.*

Short term debt (In millions)	**1988**	1987	1986
Commercial paper	**$ 663**	$ 831	$ 407
Master notes and other	**93**	124	190
Short term debt	**$ 756**	$ 955	$ 597
Average borrowings	**$1,194**	$ 889	$ 955
Peak outstanding	**$1,553**	$1,922	$1,257
Average interest rates	**7.6%**	6.7%	6.7%

Current maturities of long term debt (In millions)	**1988**	1987	1986
Bank loan, variable rate, due April, 1989	**$ 50**	$ —	$ —
Zero coupon note, due 1989, $200 at maturity, yields 14.25%	**194**	—	—
Sinking fund debentures called for redemption, weighted average rate of 11.5%, with maturities of 2010 to 2015	**—**	—	274
Other	**—**	—	210
Total	**$244**	$ —	$484

Long term debt (In millions)	**1988**	1987	1986
Original issue discount			
Zero coupon notes and 6% debentures, due 1992 to 1994 and 2006, $700 at maturity, yields 13.5% to 15.1%, effective rates 12.5% to 13.0%	**$ 355**	$ 488	$ 436
Debentures and notes			
5.375% to 8.875%, due 1991 to 1998	**397**	414	429
9% to 9.75%, due 1995 to 2016	**1,023**	831	656
10.2% to 11.875%, due 1990 to 1994	**224**	239	471
12.125% to 13.75%, due 1991 to 1993	**143**	295	295
Other	**53**	128	144
	2,195	2,395	2,431
Present value of commitments under capital leases	**201**	213	224
Guaranteed LESOP notes, 8.17%, due 1998*	**668**	—	—
Long term debt	**$3,064**	$2,608	$2,655
Average interest rates	**10.6%**	10.9%	11.1%

For further discussion, see LESOP on page 20.

Changes in long term debt (In millions)	**1988**	1987	1986
Increases			
9% to 11% sinking fund debentures, due 2015 to 2016	**$ —**	$ —	$ 350
8.375% to 10.875% notes, due 1990 to 1998	**200**	202	247
Amortization of original issue discount	**60**	52	46
Guaranteed LESOP notes, 8.17%, due 1998*	**700**	—	—
	960	254	643
Decreases			
Retirements from debt restructure program			
Open market purchases, weighted average rate of 12% with maturities of 1990 to 2015	**—**	—	562
Sinking fund debentures called for redemption, weighted average rate of 11.5% with maturities of 2010 to 2015	**—**	—	274
10.75% and 11.875% notes, due 1990, called in 1987	**—**	219	—
Other transfers to current maturities of long term debt	**244**	—	185
13.625% and 13.750% notes, due 1991 and 1999, called in 1988	**152**	—	—
Other, including LESOP amortization	**108**	82	66
	504	301	1,087
Net increase (decrease) in long term debt	**$456**	$ (47)	$ (444)

For further discussion, see LESOP on page 20.

Maturities of long term debt (In millions)	Long term debt	Capital leases
1989	$ 288	$ 24
1990	137	24
1991	192	24
1992	294	24
1993	111	24
1994 to 1998	1,213	94
Thereafter	556	84
Total	$2,791	298
Less future interest and executory expenses		97
Present value		$201

Other liabilities (In millions)	**1988**	1987	1986
Life insurance operation, principally policy and claims reserves	**$ 298**	$299	$256
Casualty insurance operation, principally claims reserves	**201**	198	224
Bank operation, principally customer deposits	**488**	290	89
Real estate development operation	**115**	105	89
Total	**$1,102**	$892	$658

Confirmed lines of credit available to JCPenney amounted to $900 million. None were in use at January 28, 1989.

Stockholders' equity was $3,957 million at year end 1988 compared with $4,173 million at year end 1987 and $4,340 million at year end 1986.

Preferred stock. During 1988, a leveraged employee stock ownership plan (LESOP) was created (see page 20 for further discussion). The LESOP purchased approximately 1.2 million shares of a new issue of Series B convertible preferred stock from the Company. These shares are convertible into approximately 11.8 million shares of the Company's common stock at a conversion rate equivalent to ten shares of common stock for each share of preferred stock. The convertible preferred stock may be redeemed at the option of the Company or the LESOP, under certain limited circumstances. The dividends are cumulative, yield 7.9 per cent, and are payable semi-annually on January 1 and July 1. The first dividend, amounting to $28 million, was declared on January 1, 1989. On an after-tax basis, the dividend amounted to $17 million. The convertible preferred stock issued to the LESOP has been recorded in the equity section and the "Guaranteed LESOP Obligation," representing borrowings by the LESOP, has been recorded as a reduction of stockholders' equity.

Common stock. In 1988, the Company completed the common stock buy back program adopted in 1987 of 20 million shares. Under that program, the Company purchased 7 million shares in 1988 at a cost of $351 million of which $301 million was charged to reinvested earnings and the remainder to common stock. The cost of the entire program was $932 million.

The Company is using the proceeds from the issuance of convertible preferred stock to the LESOP to purchase up to 15 million common shares in the open market. At the end of the year, the Company had purchased 8 million shares at a cost of $418 million, of which $362 million was charged to reinvested earnings and the remainder to common stock. All shares were retired and returned to the status of authorized but unissued shares of common stock.

Effective May 1, 1987, the Board of Directors declared a two-for-one stock split in the form of a 100 per cent dividend of the Company's common stock. All references to shares and per share data in the accompanying financial statements were restated to reflect the stock split. In addition, the preferred stock purchase rights which accompany each share of common stock were automatically adjusted in accordance with the rights agreement to entitle the purchase, for each right held, of $\frac{1}{200}$ of a share of Series A junior participating preferred stock at a price of $75 per $\frac{1}{200}$ of a share. Each share of common stock issued as a result of the stock split described above also included one preferred stock purchase right. The rights remain exercisable upon the occurrence of certain events and are redeemable by the Company under certain circumstances, all as described in the rights agreement.

Additionally, in 1988, 1987, and 1986, the Company purchased 568 thousand shares, 420 thousand shares, and 1.2 million shares, respectively, of its common stock from a Company benefit plan at a cost of $28 million, $23 million, and $50 million, of which $25 million, $20 million, and $42 million, respectively, were charged to reinvested earnings. All shares were retired and returned to the status of authorized but unissued shares of common stock.

The quarterly common dividend was 50 cents per share in 1988, 37 cents per share in 1987, and 31 cents per share in 1986, or an annual rate of $2.00 per share in 1988, compared with $1.48 in 1987, and $1.24 in 1986. Common dividends declared were $260 million in 1988, $218 million in 1987, and $186 million in 1986.

Changes in outstanding common stock	Shares (In thousands)			Amounts (In millions)		
	1988	1987	1986	**1988**	1987	1986
Balance at beginning of year	**138,388**	149,640	149,154	**$ 960**	$961	$929
Two-for-one stock split	**—**	—	—	**—**	38	—
Common stock issued	**377**	1,833	1,734	**11**	51	40
Common stock purchased and retired	**(15,935)**	(13,085)	(1,248)	**(109)**	(90)	(8)
Balance at end of year	**122,830**	138,388	149,640	**$ 862**	$960	$961

There were approximately 57 thousand stockholders of record at year end 1988. One of these stockholders was the savings and profit-sharing retirement plan which had 98 thousand participants and held 18.2 million shares of the Company's common stock. Additionally, the LESOP, which had approximately 90 thousand participants, held 1.2 million shares of preferred stock, convertible into 11.8 million shares of common stock. On a combined basis, these plans held approximately 24 per cent of the Company's common shares after giving effect to the conversion of the preferred stock.

1984 Equity Compensation Plan and 1984 Performance Unit Plan. Under the 1984 Equity Compensation Plan, 2.4 million shares of common stock, as well as 3 million shares available under a previous stock option plan, were initially reserved for issuance upon the exercise of options or related stock appreciation rights (SARs) and for payment of stock awards. At year end 1988, 2.4 million shares remained in reserve and were available for grant. Under this plan, ten-year incentive stock options, non-qualified stock options, and SARs and tax benefit rights (TBRs) in tandem with stock options may be granted. Options granted prior to 1987 were exercisable one year from the date of grant. Options granted thereafter generally become exercisable six months from the date of grant.

In 1987 and 1986, the Company granted SARs and TBRs to officers in tandem with certain stock option grants. With respect to SARs and TBRs, about $1 million was paid to participants in each of the last three years. In 1988 and 1987, the Company issued to its officers a total of 370 thousand shares of restricted stock awards which vest over a five year period. The awards have conditions and restrictions which are designed to assure that the officers stay in the Company's service and retain stock ownership for many years. These awards were intended in part to compensate officers for accepting significant limitations placed on an existing program. In conjunction with these awards, a maximum market price for the Company's stock was established upon the exercise of SARs.

Under the 1984 Performance Unit Plan, performance units are earned based on measurements of Company performance determined by the Personnel and Compensation Committee of the Board of Directors. Approximately $9 million was earned in 1988, $8 million in 1987, and $5 million in 1986.

The Board of Directors has approved a new 1989 Equity Compensation Plan, subject to stockholder approval. This plan replaces the 1984 Equity Compensation Plan. Under the 1989 Equity Compensation Plan, 5 million shares of common stock will be reserved for issuance.

	1988		1987		1986	
Stock options	Shares (In thousands)	Weighted average option price	Shares (In thousands)	Weighted average option price	Shares (In thousands)	Weighted average option price
Balance at beginning of year	**1,578**	**$29.15**	1,920	$24.55	3,074	$22.12
Granted	**1,223**	**45.65**	327	47.12	466	32.53
Exercised	**(343)**	**22.17**	(659)	24.60	(1,572)	22.06
Expired and cancelled	**(98)**	**44.14**	(10)	31.66	(48)	28.93
Balance at end of year	**2,360**	**$38.10**	1,578	$29.15	1,920	$24.55

Additional Financial Data

	1988		1987		1986	
Credit sales	Amounts (In billions)	Per cent of eligible sales	Amounts (In billions)	Per cent of eligible sales	Amounts (In billions)	Per cent of eligible sales
JCPenney credit card	**$7.2**	**49.0**	$7.3	49.2	$7.0	50.0
American Express, MasterCard, and Visa	**1.5**	**10.0**	1.3	9.2	1.2	8.2
Total	**$8.7**	**59.0**	$8.6	58.4	$8.2	58.2

Approximately 90 per cent of sales on the JCPenney credit card were made in accordance with the regular plan and the balance in accordance with the major purchase plan.

At year end, the number of JCPenney credit card accounts with outstanding balances was 16 million under the regular plan and 1.9 million under the major purchase plan. The average balances and maturities are shown in the table below:

	Average account balances			Average maturities (In months)		
	1988	1987	1986	**1988**	1987	1986
Regular plan	**$195**	$189	$192	**4.0**	4.0	4.4
Major purchase plan	**$514**	$523	$521	**9.9**	9.9	10.4
All	**$229**	$230	$233	**4.7**	4.9	5.2

Includes all customer receivables serviced.

Key JCPenney credit card information (In millions)	**1988**	1987	1986
Customer receivables			
Regular plan	**$3,153**	$3,064	$3,110
Major purchase plan	**973**	1,149	1,181
Total customer receivables serviced	**4,126**	4,213	4,291
Customer receivables sold	**250**	—	—
Total customer receivables	**$3,876**	$4,213	$4,291
Number of accounts with balances	**17.9**	18.2	18.3
Finance charge revenue	**$ 642**	$ 676	$ 703
Net bad debts written off	**$ 138**	$ 167	$ 153
Per cent of customer charges	**1.8**	2.1	2.0
Provision for doubtful accounts	**$ 138**	$ 159	$ 160
Accounts 90 days or more past due as a per cent of customer receivables	**2.1**	2.1	2.5

The Company's policy is to write off accounts when the scheduled minimum payment has not been received for six consecutive months, or if any portion of the balance is more than 12 months past due, or if it is otherwise determined that the customer is unable to pay. Collection efforts continue subsequent to write off, and recoveries are applied as a reduction of bad debt losses.

Advertising expense by the Company for newspapers, television, radio, and other media, excluding catalog preparation and distribution costs, was $424 million in 1988, as compared with $451 million in 1987 and $445 million in 1986.

Interest expense (In millions)	**1988**	1987	1986
Short term debt	**$ 90**	$ 59	$ 64
Long term debt	**261**	258	314
Income on short term investments	**(43)**	(24)	(27)
Other, net	**(1)**	7	(1)
Interest expense, net	**$307**	$300	$350

Rent expense (In millions)	**1988**	1987	1986
Minimum rent on noncancellable operating leases	**$198**	$193	$190
Rent based on sales	**37**	42	42
Minimum rent on cancellable personal property leases	**106**	115	116
Real estate taxes and common area costs	**103**	94	95
Total	**$444**	$444	$443

The Company conducts the major part of its operations from leased premises which include retail stores, distribution centers, warehouses, offices, and other facilities. Almost all leases will expire during the next 20 years; however, most leases will be renewed or replaced by leases on other premises.

Minimum annual rents under noncancellable leases and subleases (In millions)	Gross rents	Net rents*
1989	$ 199	$ 129
1990	189	123
1991	181	117
1992	174	113
1993	179	120
Thereafter	1,398	952
Total	$2,320	$1,554
Present value		$ 850
Weighted average interest rate		10%

**Rents are shown net of their estimated executory costs, which are principally real estate taxes, maintenance, and insurance.*

Retirement plans (In millions)	**1988**	1987	1986
Pension			
Service cost	**$ 36**	$ 39	$ 30
Interest cost	**90**	80	66
Actual return on assets	**(125)**	(78)	(137)
Amortization	**(6)**	(49)	19
Pension credit	**(5)**	(8)	(22)
Savings and profit-sharing expense	**53**	50	51
Total	**$ 48**	$ 42	$ 29

JCPenney's principal pension plan, which is noncontributory, covers substantially all United States employees who have completed 1,000 or more hours of service within a period of 12 consecutive months. In addition, the Company has an unfunded, noncontributory, supplemental retirement program for certain management employees. Benefits under the principal pension plan are 1.5 per cent of final average pay for each year of credited service to normal retirement age up to a maximum of 30 years, less up to 50 per cent of an employee's estimated Social Security benefit, as computed under the plan.

The following table sets forth the funded status of the principal pension plan and the supplemental retirement program:

Pension plans funded status (In millions)	December 31 1988	1987	1986
Present value of accumulated benefits			
Vested	**$ 686**	$ 615	$ 564
Non-vested	**72**	73	60
	$ 758	$ 688	$ 624
Present value of actuarial benefit obligation	**$1,001**	$ 934	$ 866
Net assets at fair market value	**1,164**	1,071	1,019
Excess assets	**$ 163**	$ 137	$ 153
Key assumptions			
Actuarial method	**PUC***	PUC*	PUC*
Rate of return on plan assets	**9.5%**	9.5%	9.5%
Discount rate	**9.5%**	9.5%	9.0%
Salary progression rate	**6.0%**	6.0%	6.0%

**Projected unit credit.*

The present value of accumulated benefits is based on compensation and service to date. The present value of the actuarial benefit obligation considers estimates of future compensation, but not future service, and is used to determine pension expense (credit) and funding. No contribution was required or made in the past three years.

Certain changes in plan assets and in the actuarial benefit obligation are not recognized as they occur. In addition, at the date of adopting Financial Accounting Standards Board Statement No. 87, the Company had an unrecognized excess of plan assets over the actuarial benefit obligation. These unrecognized changes more than offset the end of year excess of plan assets over the actuarial benefit obligation and are systematically amortized over subsequent periods. The Company's consolidated financial statements reflect a prepaid pension expense. During 1988, that prepaid pension expense was increased by approximately $25 million resulting from a curtailment gain applicable to employee terminations from the Company's relocation to Dallas.

The savings and profit-sharing retirement plan encourages savings by employees through the allocation of 4.5 per cent of the Company's available profits, as defined in the plan, to participants who make deposits under the plan. The eligibility requirement is the same as that of the Company's principal pension plan. After 1988, the Company will not make any contributions to this plan as the plan has been succeeded by the LESOP.

The Company provides post-retirement health care benefits to retired employees and their dependents meeting certain eligibility requirements. The Company recorded expenses for these benefits as incurred in the amounts of $12 million, $11 million, and $9 million in 1988, 1987, and 1986, respectively.

Total assets and equity (In millions)	Savings and profit-sharing December 31 1988	1987	1986	Pension December 31 1988	1987	1986
JCPenney common stock (18, 20, and 20 million shares at cost: $507, $511, and $442)	**$ 919**	$ 856	$ 731	**$ —**	$ —	$ —
Funds with insurance companies	**778**	681	604	**—**	—	—
Equity securities (cost: $16, $19, $21, $801, $780, and $643)	**39**	40	43	**889**	815	743
Fixed income investments (cost: $2, $7, $6, $172, $161, and $161)	**2**	7	6	**170**	156	165
Real estate (cost: $85, $84, and $84)	**—**	—	—	**103**	99	103
Other assets, net	**38**	54	40	**2**	1	8
Net assets	**$1,776**	$1,638	$1,424	**$1,164**	$1,071	$1,019

Changes in fair value of retirement plans' net assets (In millions)	Savings and profit-sharing December 31 **1988**	1987	1986	Pension December 31 **1988**	1987	1986
Net assets at beginning of year	**$1,638**	$1,424	$1,143	**$1,071**	$1,019	$ 903
Company contribution	**47**	50	51	**—**	—	—
Participants' contributions	**117**	112	120	**—**	—	—
Investment income	**132**	142	115	**66**	156	142
Unrealized appreciation (depreciation) of investments	**115**	103	168	**59**	(78)	(5)
Benefits paid	**(273)**	(193)	(173)	**(32)**	(26)	(21)
Net assets at end of year	**$1,776**	$1,638	$1,424	**$1,164**	$1,071	$1,019

LESOP. In 1988, the Company created a leveraged employee stock ownership plan (LESOP). Effective January 1, 1989, the LESOP succeeded the Company's employee savings and profit-sharing retirement plan.

The LESOP borrowed $700 million at an interest rate of 8.17% in a 10-year loan guaranteed by the Company. The LESOP used the proceeds of the loan to purchase a new issue of convertible preferred stock from the Company. The preferred stock is convertible into approximately 11.8 million shares of the Company's common stock at $60 per common share. The dividend yield on the preferred stock is 7.9%; the conversion rate is ten shares of common stock for each share of preferred stock. Each year, one-tenth of the preferred stock held by the LESOP is allocated to participants' accounts.

The Company is using the proceeds from the issuance of preferred stock to the LESOP to purchase up to 15 million common shares in the open market.

The Company has reflected the guaranteed LESOP borrowing as long term debt on its balance sheet. The convertible preferred stock issued to the LESOP for cash was recorded in the equity section. A like amount of "Guaranteed LESOP Obligation" was recorded as a reduction of stockholders' equity. As the Company makes annual contributions to the LESOP, these contributions, plus the dividends paid on the Company's preferred stock held by the LESOP, will be used to repay the loan. As the principal amount of the loan is repaid, the "Guaranteed LESOP Obligation" is reduced accordingly.

The employee eligibility requirement and contribution options of the LESOP are virtually the same as those of the Company's former employee savings and profit-sharing retirement plan.

Income tax expense (In millions)	**1988**	1987	1986
Current			
Federal	**$380**	$411	$127
State and local	**75**	55	15
	455	466	142
Deferred			
Federal	**(66)**	(89)	259
State and local	**(4)**	(6)	33
	(70)	(95)	292
Total income tax expense	**$385**	$371	$434
Effective tax rate	**32.3%**	37.9%	45.0%

Reconciliation of tax rates	Amounts (In millions) **1988**	1987	1986	Per cent of pre-tax income **1988**	1987	1986
Federal income tax statutory rate	**$405**	$383	$444	**34.0**	39.0	46.0
Investment tax credits	**—**	—	(7)	**—**	—	(.7)
State and local income taxes, less Federal income tax benefit	**46**	30	26	**3.9**	3.1	2.7
Employee stock ownership plan credits*	**—**	—	(8)	**—**	—	(.8)
Reduction of deferred taxes on installment sales**	**(42)**	(17)	—	**(3.5)**	(1.7)	—
Capital gains benefits and other	**(24)**	(25)	(21)	**(2.1)**	(2.5)	(2.2)
Total income tax expense	**$385**	$371	$434	**32.3**	37.9	45.0

**Expired in 1986.*

***Resulting from payment of taxes on installment sales previously deferred at higher tax rates in the financial statements.*

Taxes other than income taxes, over half of which were payroll taxes, totaled $374 million in 1988, as compared with $334 million in 1987 and $339 million in 1986.

Deferred taxes consist principally of deferred gross profit on the balances due on installment sales, accelerated depreciation, and accounting for leases.

The Company acquired certain assets under leveraged lease arrangements and purchased tax benefits under the provisions of various federal income tax acts. For income tax purposes, the Company received certain income tax deductions and credits that were used to reduce income taxes otherwise payable. Deferred taxes were provided to reflect the reversal of these tax benefits in future years.

The Tax Reform Act of 1986 eliminated the deferral of income taxes on revolving credit installment sales after fiscal year 1986 and provided that deferred taxes previously established were to be paid over the period 1987 to 1990 in installments of 15, 25, 30, and 30 per cent. At the end of fiscal year 1988, the balance of deferred taxes on installment sales reflected on the balance sheet was $400 million. The amount due within one year is shown in the current portion of deferred taxes at the prevailing statutory rate and is approximately $50 million less than the amount originally provided in the financial statements. Accordingly, income tax expense in fiscal year 1989 will be reduced by that amount.

The Financial Accounting Standards Board issued Statement No. 96 (Accounting for Income Taxes) at the end of 1987. This standard requires an asset and liability approach to accounting for differences between the tax basis of an asset or liability and its reported amount in the financial statements (temporary differences). The standard, as amended in 1988, allows a transition period which provides flexibility for adoption up to 1990. The Company did not adopt this standard in 1988. Under the accounting rules, deferred taxes will be determined by applying the provisions of enacted tax laws, and adjustments will be required for changes in tax laws and rates. If the liability method had been applied in 1988, deferred taxes reflected on the balance sheet would have been reduced by approximately $200 million, and stockholders' equity would have increased by the same amount.

Quarterly Data (Unaudited)

(In millions except per share data)	First			Second			Third			Fourth		
	1988	1987	1986	**1988**	1987	1986	**1988**	1987	1986	**1988**	1987	1986
Retail sales	**$3,174**	3,224	3,045	**3,211**	3,409	3,221	**3,610**	3,756	3,485	**4,838**	4,943	4,989
Per cent increase (decrease)	**(1.6)**	5.9	8.7	**(5.8)**	5.8	6.9	**(3.9)**	7.8	7.4	**(2.1)**	(0.9)	6.5
Total revenue	**$3,279**	3,324	3,146	**3,341**	3,508	3,322	**3,726**	3,863	3,583	**4,950**	5,052	5,100
Per cent increase (decrease)	**(1.4)**	5.7	8.8	**(4.8)**	5.6	6.9	**(3.5)**	7.8	7.6	**(2.0)**	(0.9)	5.9
Gross margin, per cent of retail sales	**36.1**	35.8	34.4	**33.4**	32.9	31.8	**35.8**	34.8	34.4	**33.3**	32.3	33.7
Selling, general, and administrative expenses, per cent of retail sales	**26.9**	26.6	26.4	**27.5**	26.2	26.3	**27.0**	25.1	25.8	**22.8**	21.3	22.4
Income before nonrecurring and extraordinary items	**$ 131**	136	87	**81**	103	57	**160**	171	116	**296**	296	270
Per cent increase (decrease)	**(3.8)**	55.8	73.1	**(21.3)**	81.0	92.9	**(6.7)**	47.6	24.5	**0.1**	9.6	20.5
Net income	**$ 131**	54	63	**81**	103	46	**160**	171	116	**435**	280	253
Net income per common share												
Primary	**$ .96**	.36	.42	**.61**	.68	.30	**1.17**	1.14	.77	**3.28**	1.93	1.70
Fully diluted	**$ .96**	.36	.42	**.61**	.68	.30	**1.16**	1.14	.77	**3.19**	1.93	1.68
Dividends per common share	**$ .50**	.37	.31	**.50**	.37	.31	**.50**	.37	.31	**.50**	.37	.31
Common stock price range												
High	**$ 51**	52	36	**51**	60	43	**55**	65	42	**54**	48	44
Low	**$ 40**	40	29	**44**	46	34	**46**	38	35	**51**	38	36

Five Year Financial Summary

J.C. Penney Company, Inc. and Subsidiaries

Results for year (In millions)	1988	1987	1986	1985	1984
Retail sales	**$14,833**	15,332	14,740	13,747	13,451
Sales of JCPenney stores and catalog	**$13,951**	13,980	13,390	12,634	12,372
Per cent increase (decrease)	**(0.2)**	4.4	6.0	2.1	12.1
Per cent increase in general merchandise inflation	**3.2**	2.8	1.2	2.0	1.0
Gross margin, per cent of retail sales	**34.5**	33.8	33.6	32.8	32.9
Selling, general, and administrative expenses, per cent of retail sales	**25.7**	24.4	24.9	25.1	25.1
Interest, net, per cent of retail sales	**2.1**	2.0	2.3	2.7	2.6
Depreciation and amortization	**$ 258**	241	229	212	198
Income before income taxes and nonrecurring items	**$ 970**	1,151	964	679	711
Per cent of total revenue	**6.3**	7.3	6.3	4.8	5.2
Income taxes	**$ 385**	371	434	282	276
Income before nonrecurring and extraordinary items	**$ 668**	706	530	397	435
Per cent increase (decrease) from prior year	**(5.4)**	33.2	33.5	(8.7)	(6.8)
Per cent of stockholders' equity	**16.0**	16.3	13.1	10.4	12.2
Net income	**$ 807**	608	478	397	435
Earnings per common share					
Primary					
Income before nonrecurring and extraordinary items	**$ 4.96**	4.77	3.53	2.66	2.90
Net income	**$ 6.02**	4.11	3.19	2.66	2.90
Fully diluted					
Income before nonrecurring and extraordinary items	**$ 4.90**	4.77	3.51	2.63	2.89
Net income	**$ 5.92**	4.11	3.17	2.63	2.89
Per common share					
Dividends	**$ 2.00**	1.48	1.24	1.18	1.18
Stockholders' equity	**$ 32.18**	30.15	29.00	27.16	25.63
Financial position (In millions)					
Receivables, net	**$ 4,233**	4,536	4,614	4,504	4,019
Merchandise inventories	**$ 2,201**	2,350	2,168	2,298	2,383
Properties, net	**$ 3,034**	2,910	2,919	2,812	2,608
Capital expenditures	**$ 487**	376	350	426	505
Total assets	**$12,254**	11,734	11,846	11,131	10,293
Total debt	**$ 4,064**	3,563	3,736	3,839	3,774
Stockholders' equity	**$ 3,957**	4,173	4,340	4,051	3,812
Number of common shares outstanding at year end (In millions)	**123**	138	150	149	148
Weighted average common shares (In millions)					
Primary	**131**	148	150	150	150
Fully diluted	**136**	148	151	151	151
Number of employees at year end (In thousands)	**190**	181	176	177	180

All per share amounts reflect the 1987 two-for-one stock split.

Five Year Operations Summary

J.C. Penney Company, Inc. and Subsidiaries

	1988	1987	1986	1985	1984
JCPenney metropolitan market stores					
Number of stores	**698**	699	707	729	749
Gross selling space (In million sq. ft.)	**94.7**	95.4	96.1	96.7	97.2
Sales (In millions)	**$11,313**	11,463	11,001	10,382	10,093
Sales per gross square foot	**$ 118**	119	114	107	105
JCPenney geographic market stores					
Number of stores	**657**	679	696	753	821
Gross selling space (In million sq. ft.)	**18.6**	18.2	18.4	18.8	19.2
Sales (In millions)	**$ 2,051**	1,965	1,887	1,783	1,820
Sales per gross square foot	**$ 113**	106	101	93	95
Number of JCPenney stores	**1,355**	1,378	1,403	1,482	1,570
Catalog					
Number of sales facilities	**1,879**	1,837	1,825	1,733	1,804
Number of distribution centers	**6**	6	6	6	6
Distribution space (In million sq. ft.)	**11.4**	11.4	11.4	11.4	11.4
Sales (In millions)	**$ 2,918**	2,585	2,332	2,000	1,928
Drug stores					
Number of stores	**434**	407	390	374	369
Gross selling space (In million sq. ft.)	**4.4**	4.2	4.1	4.0	3.9
Sales (In millions)	**$ 976**	875	802	702	649
Sales per gross square foot	**$ 236**	215	204	180	170

Catalog sales made through JCPenney stores and drug stores are included in the sales of those stores as well as in Catalog. Sales per gross square foot include only those sales from stores in operation throughout both the current and prior year.

Public Affairs

The Company made significant progress during 1988 in its commitment to contributing to the health and vitality of the communities in which we do business. Involvement in this commitment occurred at all levels of the organization in such broad areas of concern as charitable contributions, community service programs, and minority affairs.

Charitable contributions in 1988 were $18.4 million compared with $14.5 million in 1987. Approximately 70 per cent of the contributions were made by JCPenney units to community based organizations and 30 per cent to national organizations that impact communities in which the Company operates. JCPenney employees pledged an additional $5.9 million to local United Ways through payroll deductions and one-time gifts.

Community service programs were expanded during 1988 with the introduction of the Golden Rule Network. The Network utilizes the Company's business television network to provide information and materials that address social issues to communities in which we do business. The initial broadcast dealt with teenage substance abuse.

Volunteerism continued to be encouraged through the annual Community Service Awards, which recognize employees for outstanding volunteer activities and providing a contribution to their community organization. The Golden Rule Award program provides similar recognition to volunteers outside the Company. This program was expanded to 55 markets in 1988, and through it the Company contributed $259 thousand to local organizations.

The Company is committed to programs fostering equal opportunity for all and has continued to expand the purchase of merchandise and services from minority-owned companies. During 1988, minority purchases increased to $263.2 million, representing relationships with 1,487 suppliers.

J.C. Penney Company, Inc.

Directors

M. Anthony Burns[1,4]
Chairman, President and Chief Executive Officer, Ryder System, Inc.

Colby H. Chandler[3,4]
Chairman and Chief Executive Officer, Eastman Kodak Company

William M. Ellinghaus[1,4]
Formerly President, American Telephone and Telegraph Company

Clifton C. Garvin, Jr.[1,2]
Formerly Chairman and Chief Executive Officer, Exxon Corporation

Robert B. Gill
Vice Chairman of the Board

William R. Howell
Chairman of the Board

Vernon E. Jordan, Jr.[2,4]
Partner, Law Firm of Akin, Gump, Strauss, Hauer & Feld

Juanita M. Kreps[1,4]
Economist and Educator
Formerly United States Secretary of Commerce

David F. Miller
Vice Chairman of the Board and Chief Operating Officer, JCPenney Stores and Catalog

George Nigh[3,4]
Formerly Governor of Oklahoma

Jane C. Pfeiffer[2,3]
Independent Management Consultant

Donald V. Seibert[2,3,5]
Formerly Chairman of the Board

Joseph D. Williams[5]
Chairman and Chief Executive Officer, Warner-Lambert Company

Walter B. Wriston[1,3,5]
Formerly Chairman, Citicorp and Citibank, N.A.

Boris Yavitz[1,2,5]
Paul Garrett Professor of Public Policy and Business Responsibility and Former Dean, Graduate School of Business, Columbia University

Office of the Chairman

William R. Howell
Chairman of the Board

Robert B. Gill
Vice Chairman of the Board

David F. Miller
Vice Chairman of the Board and Chief Operating Officer, JCPenney Stores and Catalog

JCPenney Stores

James E. Oesterreicher
Executive Vice President
Director of JCPenney Stores

W. Barger Tygart
Executive Vice President
Director of Merchandising

C. Kenneth Ogg
Vice President
Director of Operations, Services, and Inventory Management

Charles W. Stewart
Vice President
Director of Strategic Development for JCPenney Stores and Catalog

John T. Cody, Jr.
President
Northwestern Region

William J. Ferguson
President
Southwestern Region

R.H. Seaman
President
Southeastern Region

Richard C. Sherwood
President
Northeastern Region

James L. Hailey
President
Children's Division

Thomas D. Hutchens
President
Men's Division

James J. Kennedy
President
Home and Leisure Division

John A. McConville
President
Women's Division

J. Thomas Arthur
Vice President
Director of Marketing, Home and Leisure Division

Marshall Beere
Vice President
Director of Merchandise, Women's Division

Andrew Cumming
Vice President
Director of Marketing, Children's Division

David E. Fulcomer
Vice President
Director of Merchandise, Home and Leisure Division

Ralph W. LaRovere
Vice President
Director of Merchandise, Men's Division

W.E. McCarthy
Vice President
Director of Marketing, Women's Division

J. Raymond Pierce
Vice President
Director of Marketing, Men's Division

Kenneth T. Russo
Vice President
Director of Merchandise, Women's Division

Henry H. Scott
Vice President
Director of Merchandise, Children's Division

Catalog

Rodney M. Birkins
President

Julius L. Debbs
Vice President
Director of Merchandising

Peter G. Fenlon
Vice President
Director of Sales and Operations

William J. Kelly
Vice President
Director of Advertising and Publications

Corporate

Terry S. Prindiville
Executive Vice President

Richard T. Erickson
Senior Vice President
Director of Corporate Personnel

Charles R. Lotter
Senior Vice President
Secretary and General Counsel

Robert E. Northam
Senior Vice President
Chief Financial Officer

John A. Wells
Senior Vice President
Director of Real Estate and Construction Services

Vice Presidents

Robert O. Amick
Controller

Charles L. Brown
Director of Auditing

James P. Bryant
Director of Corporate Taxes

Joseph J. DeMelio
Director of Insurance

Gale Duff-Bloom
Director of Investor Relations

David V. Evans
Director of Systems and Data Processing

William R. Johnson
Director of Public Affairs and Company Communications

Robert J. Keller
Director of Construction Services

Donald A. McKay
Treasurer

Ted L. Spurlock
Director of Credit and Consumer Banking Services

George M. Stone
Director of Government Relations

Michael Todres
Director of Distribution

Assistant Controllers

William J. Alcorn
Leo A. Gispanski

Assistant Secretary and Assistant General Counsel

Robert S. Gorin

Assistant Secretaries

Frank J. Bonet
Cornelius T. Dorans
John V. Faltermeier
Margaret R. Johnson
Richard M. Kleid

Assistant Treasurers

Robert B. Cavanaugh
Thomas A. Clerkin

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1. Member of the Audit Committee of the Board of Directors. This committee recommends to the Board of Directors the independent auditors to be employed for the purpose of conducting the annual audit of the Company's financial statements, discusses with the auditors the scope of their examination, reviews the Company's financial statements and the auditors' report with Company personnel and the auditors, determines whether the auditors have received all the explanations and information they had requested, and invites the recommendations of the auditors regarding internal controls and other matters.
2. Member of the Public Affairs Committee. This committee identifies, analyzes, and brings to the attention of the Board social and environmental trends and public policy issues which may have a potential impact on the business performance and investment character of the Company. It assures that Company policy and performance reflect a sensitivity toward the social and physical environments in which the Company does business and that such policy and performance are in accord with the public interest.
3. Member of the Committee on Directors. This committee makes recommendations to the Board with respect to the size, composition, and functions of the Board of Directors, the qualifications of directors, candidates for election as directors, and the compensation of directors.
4. Member of the Personnel and Compensation Committee. This committee reviews the Company's annual and long term incentive compensation plans, makes recommendations in areas concerning personnel relations, and takes action or makes recommendations with respect to the compensation of Company executive officers, including those who are directors. It is also the committee which acts under certain of the Company's incentive compensation and retirement plans.
5. Member of the Benefit Plans Review Committee. This committee reviews annually the financial condition and investment performance results of the Company's retirement plans, annual actuarial valuation reports for the Company's pension plan, and the financial condition, investment performance results, and actuarial valuation aspects of the Company's welfare plans.

All of the committees described above are composed entirely of outside directors.

Transfer Agents

J.C. Penney Company, Inc.
Securityholder Services
Pittsburgh Accounting Center
P.O. Box 407
Pittsburgh, Pennsylvania 15230

Registrar and Transfer Company
61 Broadway, Room 1412
New York, New York 10006

Registrars

Registrar and Transfer Company
61 Broadway, Room 1412
New York, New York 10006

Wilmington Trust Company
Wilmington, Delaware 19899

Exchange Listings

The New York Stock Exchange
(Ticker symbol—JCP)

Brussels and Antwerp Stock Exchanges

Supplemental Information

Copies of the Company's Form 10-K annual report for 1988 to the Securities and Exchange Commission and consolidated Employer Information Reports EEO-1 for 1988 year end to the United States Equal Employment Opportunity Commission will be made available upon request to:

Ms. Nancee Dixon
J.C. Penney Company, Inc.
Public Relations
P.O. Box 659000
Dallas, Texas 75265-9000
Phone: (214) 591-1488

Copies of J.C. Penney Funding Corporation's annual report are available from:

Mr. Thomas A. Clerkin
J.C. Penney Funding Corporation
P.O. Box 659000
Dallas, Texas 75265-9000
Phone: (214) 591-2010

Inquiries about your stockholder record should be forwarded to:

Mrs. Marty Corna
J.C. Penney Company, Inc.
Securityholder Services
P.O. Box 407
Pittsburgh, Pennsylvania 15230
Phone: 1-800-842-9470
Monday-Friday, 7:30 A.M.-4 P.M., EST

J.C. Penney Company, Inc.
14841 North Dallas Parkway, Dallas, Texas 75240-6760